

THE HONORABLE MARSHA J. PECHMAN

UNITED STATES DISTRICT COURT
WESTERN DISTRICT OF WASHINGTON
AT SEATTLE

IN RE: WASHINGTON MUTUAL
MORTGAGE BACKED SECURITIES
LITIGATION

This Document Relates to: ALL CASES

Master Case No.: C09-0037 (MJP)

**PLAINTIFFS' OPPOSITION TO
DEFENDANTS' MOTION TO EXCLUDE
THE PROFFERED EXPERT
TESTIMONY OF SCOTT D. HAKALA**

**Note on Motion Calendar:
August 3, 2012**

ORAL ARGUMENT REQUESTED

PLAINTIFFS' OPPOSITION TO DEFENDANTS' MOTION TO
EXCLUDE PROFFERED EXPERT TESTIMONY OF
SCOTT D. HAKALA
Case No. C09-037 MJP

SCOTT+SCOTT LLP
707 Broadway, Suite 1000
San Diego, CA 92101
Telephone: (619) 233-4565

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INTRODUCTION

Plaintiffs hereby respond to and oppose Defendants' Motion to Exclude the Proffered Expert Testimony of Scott D. Hakala dated July 2, 2012 ("Defendants' Brief") (ECF No. 465). Dr. Hakala produced analyses and developed values of the Certificates as of the date that the initial complaint was filed for purposes of Section 11(e) in this case using prices and quotes for comparable arm's-length sales. This is the methodology for determining "value" as of the Section 11(e) measurement date that is preferred by the courts and the relevant accounting and appraisal authorities.

Defendants' contention that actual arm's-length prices should be rejected in favor of a discounted cash flow method ("DCF") where there is less than full market "efficiency" as that term has been used in Section 10(b)-5 cases as a predicate for establishing "fraud-on-the-market" reliance has been specifically rejected by the Ninth Circuit. Nor do Defendants' other arguments that Dr. Hakala's opinions are unreliable or arbitrary have any merit. Indeed, Defendants' positions are little more than an ill-conceived effort to shift the burden of establishing loss causation and damages to Plaintiffs in violation of the presumptions provided in Section 11(e).

BACKGROUND

In this case, Plaintiffs allege violations of Section 11 of the Securities Act of 1933 against WaMu Capital Corporation, WaMu Asset Acceptance Corporation, and certain of its individual officers ("WaMu"). Under §11(e), loss causation and damages are presumed and Plaintiffs need only submit proof of the value of the securities at the time the initial complaint is filed and at other dates the securities are sold, to establish their *prima facie* case.

Dr. Hakala, in his expert report dated March 2, 2012 ("Hakala Report") (attached as Exhibit 5 to the Declaration of Jesse M. Weiss in Support of Defendants' Motion for Summary Judgment (ECF No. 384-1)), explains that he was asked to determine the values of each of the Certificates in the certified class at the time of the filing of the first operative complaint and then

1 to estimate presumptive damages. Hakala Report, ¶1. In his report, Dr. Hakala calculated
 2 presumed damages to the Class under Section 11(e) based on the value of the Certificates as of
 3 the filing of the complaint. Dr. Hakala explains that he determined the value of each Certificate
 4 by looking first at actual transaction prices in the weeks surrounding August 4, 2008. Then, he
 5 looked to quoted prices from various sources and finally, he looked to transaction prices in the
 6 few months prior to August 2008 and through January 2009 and then adjusted those prices for
 7 known changes in transaction price quotes and estimates. His method was thus to look first and
 8 foremost at arm's-length transactions as evidence of value under Section 11(e). As stated by
 9 Hakala in his report:

10 The basic protocol in determining investor losses included consideration
 11 first of actual transaction prices in the weeks or months before, on and relatively
 12 soon (within one month) after August 4, 2008. Second, I considered quoted
 13 prices provided from various sources, including quoted market prices on account
 14 statements at the end of July and August 2008 for the Lead Plaintiffs and FT
 15 Interactive estimated prices as of August 4, 2008. Finally, I considered
 16 transaction prices in the few months prior to August 2008 and through January
 17 2009 and then adjusted those prices (when possible) for known changes in
 18 transaction price quotes and estimates provided by FT Interactive and in the
 19 broker transaction data for certificates with similar prices and performance
 20 characteristics. For the senior certificates, at least two of these three methods
 21 were always available. For the subordinated certificates at least one of these three
 22 methods was always available.

23 Hakala Report, ¶32.

24 Dr. Hakala consistently applied this hierarchy of information used to determine value.
 25 Put another way by Dr. Hakala at his deposition:

26 ... your primary basis should be known transactions that are validated as meeting
 27 the fair market value arm's length definition should be given first weight and first
 28 priority. The second priority should be given to known quotes or indication to
 interest. When those two are missing, to the extent you have trades further away,
 adjustments to those prices to the current date would be acceptable.

Transcript of 6/8/12 Deposition of Scott D. Hakala (attached as Exhibit 1 to the Declaration of John T. Jasnoch filed herewith) (“Hakala Tr.”) at 76:23-25; 77:2-8. As further summarized by Dr. Hakala at his deposition, “[t]here’s a clear hierarchy that where the transactions data is relatively robust or I can make adjustments, I’ll give first priority to transactions data, consistent with appraisal practice, and then second to price quotes, and then third, to the extent I have to, I’ll use much more distant price quotes or transactions to interpolate into the proper value.” Hakala Tr. at 51:7-15.

ARGUMENT

A. Legal Standard

Federal Rule of Evidence 702 allows admission of “scientific, technical, or other specialized knowledge” by an expert witness under several conditions. As a “general principle . . . Rule 702 is applied consistent with ‘the liberal thrust’ of the Federal Rules and their ‘general approach of relaxing the traditional barriers to opinion testimony.’” *Jinro Am. Inc. v. Secure Inv., Inc.*, 266 F.3d 993, 1004 (9th Cir. 2001) (citing *Daubert v. Merrell Dow Pharms., Inc.*, 509 U.S. 579, 588 (1993)); *see also* 31A AM. JUR. 2D EXPERT AND OPINION EVIDENCE §23. Although the proponent of the expert has the burden of proving admissibility, *Lust v. Merrell Dow Pharms., Inc.*, 89 F.3d 594, 598 (9th Cir. 1996), “[d]oubts . . . should generally be resolved in favor of admissibility.” *U.S. v. Finch*, 630 F.3d 1057, 1062 (8th Cir. 2011).¹

The expert witness should be “qualified . . . by knowledge, skill, experience, training, or education.” Fed. R. Evid. 702. In addition to this preliminary question, “Rule 702 embodies ‘the twin concerns of reliability and helpfulness.’” *Stilwell v. Smith & Nephew, Inc.*, 482 F.3d 1187, 1192 (9th Cir. 2007). The reliability requirement ensures that “testimony has ‘a reliable basis in the knowledge and experience of [the relevant] discipline.’” *Kumho Tire Co. v. Carmichael*, 526 U.S. 137, 149 (1999) (quoting *Daubert*, 509 U.S. at 592). The reliability inquiry is flexible and

¹ Unless otherwise noted, citations are omitted and emphasis is added.

depends on the circumstances of each case. *U.S. v. Prime*, 363 F.3d 1028, 1032-34 (9th Cir. 2004). Rule 702’s helpfulness requirement is the capacity of the testimony to “help the trier of fact.” Fed. R. Evid. 702. Here, Dr. Hakala’s testimony is both reliable and helpful as further described below.

B. The Hierarchy Used by Hakala Is Supported by Numerous Sources

Hakala’s valuation hierarchy is wholly consistent with copious credible and esteemed sources on valuation that are customarily relied upon in valuation analyses. To begin with, the Public Company Accounting Oversight Board (“PCAOB”) specifically allows for and endorses Hakala’s approach to determining current “fair values” as of a defined measurement date. PCAOB, AU Section 328, “Auditing Fair Value Measurements and Disclosures” (attached to the Declaration of Scott D. Hakala (“Hakala Decl.”) as Ex. A) specifically notes that GAAP “expresses a preference for the use of observable market prices to make that determination [of fair value].” *Id.* at .03, and that “[i]n the absence of observable market prices, GAAP requires fair value to be based on the best information available in the circumstances.” *Id.* Furthermore, Section .08 of that standard explicitly states that “the existence of published price quotations in an active market is the best evidence of fair value.” Therefore, Hakala’s approach of looking first to market prices and then to a ladder of other information to determine value is promoted by the PCAOB.

Furthermore, the Financial Accounting Standards Board (“FASB”) has likewise endorsed Hakala’s approach. FASB created FAS157 (attached to the Hakala Decl. as Ex. B) as a specific guidance for determining the “fair value” of securities, **including** mortgage-backed securities. *See Statement of Financial Accounting Standards No. 157: Fair Value Measurements*, September 2006, currently amended by the Financial Accounting Standards Board. FAS157 defines “fair value” as “the price that would be received to sell an asset or paid to transfer a

1 liability in an orderly transaction between market participants at the measurement date.” *Id.*, ¶15
 2 at 157-8. For purposes of §11(e), the “measurement date” is the date the complaint is filed.

3 One of the stated purposes of FAS157 was to establish a framework to best measure fair
 4 value, and it specifically creates a hierarchy for valuing assets, including securities, by giving
 5 precedence to “observable” and objective market prices and data over more assumptive
 6 “unobservable inputs,” such as a DCF:

7 . . . a fair value measurement should be determined based on the assumptions that
 8 market participants would use in pricing the asset or liability. As a basis for
 9 considering market participant assumptions in fair value measurements, this
 10 Statement establishes a fair value hierarchy that distinguishes between (1) market
 11 participant assumptions developed based on market data obtained from sources
 independent of the reporting entity (observable inputs) and (2) the reporting
 entity’s own assumptions about market participant assumptions developed based
 on the best information available in the circumstances (unobservable inputs).

12 FAS 157-3. More specifically, Section 22-A *et seq.* sets forth a “fair value hierarchy” that “gives
 13 the highest priority to quoted prices (unadjusted) in active markets for identical assets or
 14 liabilities (Level 1) and the lowest priority to unobservable inputs (Level 3).” FAS 157-12.
 15 FAS157 applies to valuation of securities and, in particular, provides examples that discuss its
 16 applicability to mortgage-backed securities. Courts have adopted FAS157 and its hierarchy as a
 17 “[f]ramework for measuring fair value.” *See In re the Bear Stearns Cos., Inc. Secs., Deriv., and*
 18 *ERISA Litig.*, 763 F. Supp. 2d 423,475 (S.D.N.Y. 2011). FAS157 is thus a credible, reliable, and
 19 endorsed guide for valuing the mortgage-backed securities in this case.

20 Hakala followed the hierarchy of FAS157 almost exactly – looking first to actual market
 21 prices where available and then to similar transactions and finally to other categories of
 22 information. His analysis thus tracks the language of FAS157 completely. The authorities cited
 23 above therefore set forth the same hierarchy for determining value with preference given to
 24 arm’s-length transactions at or around the valuation date.

1 Finally, Dr. Hakala's valuations are consistent with the "Market Approach to Business
2 Valuation," including for securities, under the Uniform Standards of Professional Appraisal
3 Practice ("USPAP"). See USPAP Advisory Opinions, 2010-2011 edition at 12-13 (attached to
4 the Hakala Decl. as Ex. C).

5 Thus, the analyses performed by Dr. Hakala are consistent with professional appraisal
6 reports and other applicable ways to value securities, including mortgage-backed securities. As
7 such, Dr. Hakala's methods are reliable under Fed. R. Evid. 702.

8 **C. Section 11(e) Requires a Consideration of Market Prices in Determining Value**

9 The Courts have similarly espoused a preference for objective market prices in
10 determining "value" under §11(e). At a minimum, even when market prices are not wholly
11 reliable, they are an appropriate starting point in reaching a position on "value." The fact that
12 *some* judgment is required in arriving at a damages number does not mean it should be excluded.

13 The case of *McMahan & Co. v. Warehouse Entm't, Inc.*, 65 F.3d 1044, 1049 (2d Cir.
14 1995) (cited, but not followed by Defendants) is instructive here and shows how courts have
15 specifically approved Dr. Hakala's methods and analysis. In that decision, the Second Circuit
16 expressly stated that "instances where the market price of a security will be different from its
17 value are 'unusual and rare' situations Indeed, in a market economy, when market value is
18 available and reliable, 'market value will always be the primary gauge of an enterprise's worth.'
19 Furthermore, the court went on to state that "[m]oreover, even where market price is not
20 completely reliable, it serves as a good starting point in determining value." The court then
21 directed the district court, in applying the statutory damages formula set forth in Section 11(e), *to*
22 *begin with the market price to determine true value.* See also *American Bankruptcy Institute*
23 *Law Review*, Spring 2012, Judge Christopher S. Sontchi, U.S. Bankruptcy Judge for the District
24 of Delaware ("Courts have consistently held that use of actual market data is the preferred
25

1 method to value an asset.”). Therefore, Hakala’s decision to rely first on actual market prices is
 2 in keeping with not only valuation guidelines, but also judicial authority.

3 **D. Defendants’ Argument Surrounding Market Efficiency Is Misplaced**

4 Defendants also find fault with Dr. Hakala’s use of market prices because they argue that
 5 the Certificates at issue did not trade in an efficient market. Absent an efficient market, they
 6 claim his reliance on actual transaction prices is “nonsensical.” This is simply not the law.

7 To begin with, Dr. Hakala *did not* agree that the market was wholly inefficient, as
 8 Defendants suggest in their brief. See Defendants’ Brief at 11 (“[a]s both Dr. Hakala and
 9 Dr. James agree, the market at issue was not efficient under *Cammer*”). Instead, Hakala testified
 10 that the market, in fact, was *informationally efficient*. Hakala Tr. at 79:5-24. Defendants’
 11 argument (as echoed by their expert, Christopher James) that actual prices should be ignored
 12 unless there is “*Cammer*-like efficiency” has been specifically rejected by the Ninth Circuit in
 13 *Miller v. Thane Int’l, Inc.*, 615 F.3d 1095 (9th Cir. 2010). Plaintiffs thus dispute that
 14 “efficiency,” as that term is used for determining whether “reliance” in a 10(b)-5 case may be
 15 presumed under *Cammer v. Bloom*, 711 F. Supp. 1264 (D.N.J. 1989), has any bearing on the
 16 reliability of the actual prices used by Hakala for the purposes of a Section 11(e) damages
 17 analysis.

18 Like here, defendants in *Thane Int’l* argued that stock price evidence could not be used
 19 for valuation purposes when the market for a stock is not “*Cammer*-level efficient.” The court
 20 specifically and definitely rejected this position, stating that “[t]he absence of *Cammer* efficiency
 21 does not mean that prices are unreliable.” In so holding, the Ninth Circuit also noted how the
 22 Second Circuit had decided similarly in *Akerman v. Oryx Commc’ns, Inc.*, 810 F.2d 336 (2nd
 23 Cir. 1987). In that case, the court noted a “thin” or an inefficient market but nonetheless relied
 24 on actual prices as the appropriate measure of damages.

1 There can thus be absolutely no doubt here that actual prices as determined in arm's-
 2 length sales can and should be used as a measure of damages even if the market were deemed
 3 "thin" or inefficient. The law from within this Circuit is patently clear on that fact. Thus,
 4 Hakala's use of arm's-length transaction data is both appropriate and reliable.

5 **E. Hakala's Opinions Are Not Inconsistent or Arbitrary**

6 Contrary to Defendants' assertions, Hakala's opinion is neither arbitrary nor inconsistent.
 7 Defendants make much of damages schedules appending proofs of claims filed in the United
 8 States Bankruptcy Court for the District of Delaware for the Washington Mutual Inc.
 9 bankruptcy. These, however, were specifically identified as preliminary and were not based on
 10 the full pricing data that was used for Dr. Hakala's expert report in this case. The bankruptcy
 11 submissions were prepared for a motion to estimate the amount of Plaintiffs' class claim
 12 prepared on an expedited basis due to impending court deadlines relating to the scheduled vote
 13 of a proposed bankruptcy plan. Because of the time limitations, Dr. Hakala did not review and
 14 validate the extensive hard-copy production of purchase and sale transaction data made in
 15 response to Plaintiffs' third-party subpoenas. *See* Hakala's Decl., ¶3. For the bankruptcy case,
 16 Dr. Hakala performed a "limited" review to obtain his numbers, which were "only preliminary
 17 estimates of value [that] were necessary for submission with proofs of claim and for an
 18 upcoming hearing for which an estimate of damages was necessary to temporarily allow a claim
 19 for voting purposes." *Id.* His estimate was performed simply to make an initial determination in
 20 connection with the filing of a proof of claim, much like a damages estimate prepared in
 21 connection with a complaint.² Indeed, the Ninth Circuit has a "long-established liberal policy
 22 toward amendment of proofs of claim." *Matter of Pizza of Hawaii, Inc.*, 761 F.2d 1374, 1381
 23 (9th Cir. 1985); *In re Sambo's Restaurants, Inc.*, 754 F.2d 811, 816 (9th Cir. 1984); *Sun Basin*

24 _____
 25 ² A \$273.2 million proof of claim was replaced with one for \$435 million after the tranches
 26 in the class were changed. Hakala Decl., ¶3.

1 *Lumber Co. v. U.S.*, 432 F.2d 48, 49 (9th Cir. 1970) (*per curiam*); *In re Franciscan Vineyards,*
 2 *Inc.*, 597 F.2d 181, 182 (9th Cir. 1979) (*per curiam*).

3 **F. Defendants' Argument Surrounding DCF Is Disingenuous**

4 Defendants suggest that Hakala *should* have used a DCF approach to estimating
 5 Plaintiffs' losses. Defendants' Brief at 11-12. However, this argument is intended solely to trap
 6 Plaintiffs and to set their expert up for failure.

7 Defendants on the one hand argue that Hakala's applied methodology is too "subjective"
 8 and then suggest DCF as the preferable method. However, DCF is actually the least reliable
 9 pricing method because it is only as reliable as its assumption about future performance of the
 10 mortgage loans. Therefore, DCF would require far *more* subjectivity and would require sharply
 11 disputed assumptions about trends in payment defaults and credit losses where some, but not all,
 12 of the truth about Defendants' underwriting deficiencies had been disclosed. Tellingly,
 13 Defendants' expert, Dr. James, performed no such DCF calculations or suggested the credit loss
 14 assumptions which he believed should be used in such a calculation. Indeed, because Dr. James
 15 has offered a "negative causation" opinion that *all of* Plaintiffs' losses were attributable to causes
 16 unrelated to the alleged misrepresentations, Defendants' insistence on using a DCF methodology
 17 is a transparent effort to avoid the §11(e) presumption of loss causation and make loss causation
 18 an element of Plaintiffs' *prima facie* case.

19 At his June 2012 deposition, Hakala explained that he considered and, in fact, performed
 20 a discounted cash flow analysis initially but determined that it was "too assumptive" and
 21 "required too much assumption on [his] part" Hakala Tr. at 44:20; 45:10. Numerous
 22 prominent sources agree with this conclusion. For example, in Uniform Standards of
 23 Professional Appraisal Practice, 2010-2011, Statement 2, it is specifically stated that "[b]ecause
 24 DCF analysis is profit oriented and dependent on the analysis of uncertain future events, it is
 25 vulnerable to misuse." *See Uniform Standards of Professional Appraisal Practice* as

1 promulgated by the Appraisal Foundation, 2010 to 2011 edition (selected portions attached as
 2 Ex. A to Hakala Decl.). Furthermore, the PCAOB agrees. In Section .19, it states that “the
 3 introduction of an active market for an equity security may indicate that the use of the discounted
 4 cash flows method to estimate the fair value of the security is no longer appropriate.” *See* Ex. A
 5 to Hakala Decl. Defendants also make much of Dr. Hakala’s use of subsequent transactions for
 6 valuation purposes. However, this is also a recognized tool. The PCAOB specifically allows for
 7 use of subsequent events or transactions. In Section .41, it is stated that such events or
 8 transactions “may provide audit evidence regarding management’s fair value measurements as of
 9 the balance-sheet date.” *See* Ex. A to Hakala Decl. Likewise, the Appraisal Foundation
 10 promulgated Statement 3 that specifically addresses the fact that retrospective appraisals may be
 11 required for suits to recover damages. *See* Ex. C to Hakala Decl. Finally, Defendants have taken
 12 the statement from Plaintiffs’ other expert, Dr. Zissu, entirely out of context. In her deposition,
 13 Dr. Zissu was discussing how investors evaluated an offering’s pricing. *See* Ex. 1 to Declaration
 14 of Brendon DeMay [ECF No. 466] at 102:24-104:12. Certainly, before there are comparable
 15 arm’s-length sales, a DCF is the only means available to reach a purchasing decision.

16 Therefore, Hakala actually opted to employ a more reliable and less subjective method
 17 for his expert opinion. Under Section 11, arm’s-length transactions are the best evidence of
 18 “value” as a matter of law and as confirmed by numerous guidelines and oversight boards.
 19 Defendants’ insistence that Plaintiffs must develop a discounted cash flow model – which
 20 conveniently requires them to prove up the credit losses attributable to Defendants’ poor
 21 underwriting – is nothing more than a disingenuous effort to reverse the burdens of §11(e) on
 22 loss causation and damages.

CONCLUSION

For the reasons stated herein, Plaintiffs respectfully ask that this Court deny Defendants' motion to exclude in its entirety and fully permit the testimony and opinions of Scott D. Hakala.

Dated: July 30, 2012

Respectfully submitted,
SCOTT+SCOTT LLP

/s/ Beth Kaswan

Beth Kaswan (admitted *pro hac vice*)
Amanda F. Lawrence (admitted *pro hac vice*)
500 Fifth Avenue, 40th Floor
New York, New York 10110
Telephone: (212) 223-6444
Fax: (212) 223-6334
Email: bkaswan@scott-scott.com
alawrence@scott-scott.com

Anne L. Box (admitted *pro hac vice*)
John T. Jasnoch (admitted *pro hac vice*)
SCOTT+SCOTT LLP
707 Broadway, Suite 1000
San Diego, California 92101
Telephone: 619-233-4565
Fax: 619-233-0508
Email: abox@scott-scott.com
jjasnoch@scott-scott.com

**COHEN MILSTEIN SELLERS &
TOLL PLLC**

Steven J. Toll
Joshua S. Devore (admitted *pro hac vice*)
S. Douglas Bunch (admitted *pro hac vice*)
1100 New York Avenue, N.W.
Suite 500, West Tower
Washington, DC 20005
Telephone: (202) 408-4600
Fax: (202) 408-4699
Email: stoll@cohenmilstein.com
jdevore@cohenmilstein.com
dbunch@cohenmilstein.com

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SCOTT+SCOTT LLP
707 Broadway, Suite 1000
San Diego, CA 92101
Telephone: (619) 233-4565

Christopher Lometti (admitted *pro hac vice*)
Daniel B. Rehns (admitted *pro hac vice*)
88 Pine Street, 14th Floor
New York, New York 10005
Telephone: (212) 838-7797
Facsimile: (212) 838-7745
Email: clometti@cohenmilstain.com
drehns@cohenmilstein.com

Lead Counsel for the Class

TOUSLEY BRAIN STEPHENS PLLC
Kim D. Stephens, WSBA #11984
Janissa A. Strabuk, WSBA #21827
1700 Seventh Avenue, Suite 2200
Seattle, Washington 98101
Telephone: (206) 682-5600
Facsimile: (206) 682-2992
Email: kstephens@tousley.com
jstrabuk@tousley.com

Liaison Counsel for Plaintiffs and the Class

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SCOTT+SCOTT LLP
707 Broadway, Suite 1000
San Diego, CA 92101
Telephone: (619) 233-4565

CERTIFICATE OF SERVICE

I hereby certify that on July 30, 2012, I caused the foregoing to be electronically filed with the Clerk of the Court using the CM/ECF system which will send notification of such filing to the email addresses denoted on the Electronic Mail Notice List, and I hereby certify that I caused the foregoing document or paper to be mailed via the United States Postal Service to the non-CM/ECF participants indicated on the Manual Notice List.

I certify under penalty of perjury under the laws of the United States of America that the foregoing is true and correct. Executed on July 30, 2012.

/s/ Beth Kaswan

Beth Kaswan (admitted *pro hac vice*)

500 Fifth Avenue, 40th Floor

New York, New York 10110

Telephone: (212) 223-6444

Fax: (212) 223-6334

Email: bkaswan@scott-scott.com

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SCOTT+SCOTT LLP
707 Broadway, Suite 1000
San Diego, CA 92101
Telephone: (619) 233-4565